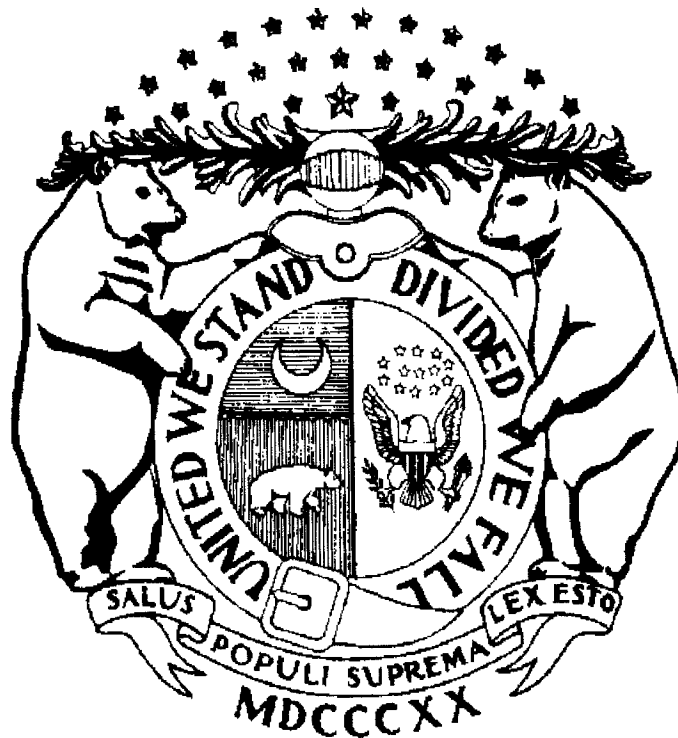


**REPORT OF THE  
ASSOCIATION FINANCIAL EXAMINATION OF  
BLUE CROSS AND BLUE SHIELD  
OF KANSAS CITY**

**AS OF  
DECEMBER 31, 2004**



**STATE OF MISSOURI  
DEPARTMENT OF INSURANCE  
JEFFERSON CITY, MISSOURI**

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Kansas City, Missouri  
March 3, 2006

Honorable Alfred W. Gross, Commissioner  
Virginia Bureau of Insurance  
Chairman of Financial Condition (EX4) Subcommittee  
Southeastern Zone Secretary

Honorable Jorge Gomez, Commissioner  
Wisconsin Department of Insurance  
Midwestern Zone Secretary

Honorable W. Dale Finke, Director  
Missouri Department of Insurance  
301 West High Street, Room 530  
Jefferson City, Missouri 65102-0690

Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

**Blue Cross and Blue Shield of Kansas City**

hereinafter referred to as such, as BCBS of Kansas City, or as the Company. Its administrative office is located at 2301 Main Street, Kansas City, Missouri 64108, telephone number 816-395-2222. This examination began on September 12, 2005, and concluded on the above date.

**SCOPE OF EXAMINATION**

**Period Covered**

The prior full scope association financial examination of BCBS of Kansas City was made as of December 31, 2001, and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC) with no other Zones participating.

The current full scope association financial examination covered the period from January 1, 2002, through December 31, 2004, and was conducted by examiners from the States of Missouri and Kansas, representing the Midwestern Zone of the NAIC.

This examination was conducted concurrently with the examinations of the Company's insurance subsidiaries, Good Health HMO, Inc. d/b/a Blue Care, Inc. (Good Health) and Missouri Valley Life and Health Insurance Company (Missouri Valley).

This examination also included the material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

### **Procedures**

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance (MDI) and statutes of the State of Missouri prevailed.

The examiners relied upon tests of controls, narrative descriptions, and other information supplied by the Company's independent auditor, Deloitte & Touche, LLP, of Kansas City, Missouri, for its audit covering the period from January 1, 2004, through December 31, 2004.

### **Comments - Previous Examination**

The comments, recommendations, and notes of the previous financial examination report dated as of December 31, 2001, are listed below with the subsequent response or action taken by the Company in regard to such comments, recommendations, and notes:

#### **Intercompany Agreements (Provider Agreement with New Directions)**

*Comment:* The Company was directed to file a Form D with the MDI regarding its transactions with New Directions Behavioral Health, LLC, (New Directions) a subsidiary, covering behavioral health and substance abuse services provided to the Company by New Directions.

*Company's Response:* The Company agreed to comply with the recommendation.

*Current Findings:* The Company has executed an agreement with New Directions for the provision of behavioral health and substance abuse services.

#### **Intercompany Agreements (Management Agreement with Premier WorkComp)**

*Comment:* The Company was directed to amend its agreement with Premier WorkComp Management, LLC (Premier WorkComp) to reflect changes in the fee structure the Company receives from WorkComp. The Company was directed to file a Form D with the MDI for a prior approval of the amended agreement.

*Company's Response:* The Company agreed to file the recommended Form D with the MDI.

*Current Findings:* The Company has executed an amended management agreement with Premier WorkComp as directed.

#### **Intercompany Transactions with Preferred Health Professionals (PHP)**

*Comment:* The Company was directed to file its agreement with PHP with the MDI covering the services provided to PHP.

*Company's Response:* The Company stated that it was drafting a new agreement with PHP and would file the agreement with the MDI after approvals by the Board of Directors of the Company and PHP.

*Current Findings:* The Company has executed an agreement with PHP to provide administrative services and access to the Company's provider networks to PHP. See the Intercompany Transaction section of this report for additional issues noted.

#### **Intercompany Transactions (Services Provided by Health Deliveries, LLC)**

*Comment:* The Company was directed to enter into a written agreement with Health Deliveries, LLC for prenatal risk assessment and educational services provided to Members of BCBS of Kansas City and file the agreement with the MDI for prior approval.

*Company's Response:* The Company stated that Healthy Deliveries, LLC was dissolved subsequent to the examination, and as such, an intercompany agreement is no longer necessary.

*Current Findings:* The examination confirmed that Healthy Deliveries, LLC is no longer an active subsidiary of the Company as it was dissolved in 2003.

#### **Reinsurance Transactions with Healthy Alliance Life Insurance Company (HALIC)**

*Comment:* The Company and HALIC has operated under a draft reinsurance agreement since 1997, whereby the Company assumed a percentage of HALIC's group contracts issued to the Missouri State Teachers Association. The Company was directed to execute a signed agreement with HALIC or desist from assuming the business.

*Company's Response:* The Company stated that it would use its best efforts to execute a signed copy of the reinsurance agreement.

*Current Findings:* The Company provided a signed copy of the agreement during this current examination.

## **Unauthorized Reinsurance**

*Comment:* The Company was directed to recognize and report as unauthorized reinsurance, cessions to an entity that did not have the authority to act as a reinsurer pursuant to the applicable Missouri laws.

*Company's Response:* The Company stated that it was reporting the underlying transaction differently as Health Care Receivable consistent with the requirements of NAIC's Statement of Statutory Accounting Principles (SSAP) #84, Certain Health Receivables and Receivables under Government Insured Plans.

*Current Findings:* The Company's current practice is consistent with the prevailing guidance provided by SSAP #84.

## **HISTORY**

### **General**

Blue Cross of Kansas City was established in 1938 to provide hospital insurance. Blue Shield of Kansas City was established in 1943 to provide insurance for physician fees. BCBS of Kansas City was created from the merger of Blue Cross of Kansas City and Blue Shield of Kansas City in 1982. The Company was incorporated on May 17, 1982, as a not-for-profit health services corporation, under the laws of Chapter 354 RSMo (Health Services Corporations sections). In 1995, the Company obtained a license to also operate as a health maintenance organization, under the laws of Chapter 354 RSMo (Health Maintenance Organization sections).

### **Capital Stock**

The Company is a not-for-profit entity. Therefore, there is no capital stock ownership.

### **Dividends**

Due to the Company's not-for-profit status, no dividends or cash distributions have been made or declared since incorporation.

### **Management**

The management of the Company is vested in a Board of Directors that are elected by the Board of Directors. The Company's Bylaws specify that the number of directors shall be no fewer than twelve (12) and no more than sixteen (16). As of December 31, 2004, fifteen (15) directors

were serving on the Board. The directors were comprised primarily of physicians, business leaders, and community leaders in the Kansas City, Missouri metropolitan area. The Board of Directors appointed and serving as of December 31, 2004, were as follows:

<u>Name</u>	<u>Address</u>	<u>Principal Occupation and Business Affiliation</u>
Tom E. Bowser	Olathe, KS	President and CEO, BCBS of Kansas City
David R. Bywaters	Shawnee Mission, KS	President, Lawrence-Leiter and Company
Melvin L. Glazer, MD	Overland Park, KS	Physician, Kansas City Medical Group
Anita B. Gorman	Kansas City, MO	Commissioner, Missouri Dept. of Conservation
Karon E. Hicks	Lake Ozark, MO	Retired Executive
Garry K. Kemp	Lee's Summit, MO	Business Manager, Greater Kansas City Building and Construction Trades Council
Janice C. Kramer	Kansas City, MO	President, Greater Kansas City Community Foundation
Ben McCallister, MD	Kansas City, MO	Endowed Chair and Director of Research, Mid-America Heart Institute
William C. Nelson	Mission Hills, KS	Chairman, George K. Baum Asset Management
Travis D. Newsome	Kansas City, MO	President, Newsome Realty Company
Sam R. Reda	Olathe, KS	Retired Executive, Lockton Benefit Services
Lyle K. Querry	Lee's Summit, MO	Business Manager, Local #53 International Brotherhood of Electrical Workers
James R. Roath	Marco Island, FL	President, J.S. Roath Investment Corporation
Larry A. Rues, MD	Kansas City, MO	Director of Family Practice Residency, Baptist Medical Center
Danley K. Sheldon	Kansas City, MO	President and CEO, Maxus Properties, Inc.



**Committees**

The Bylaws require five committees of the Board of Directors to be appointed annually. As of December 31, 2004, the members of each committee were as follows:

**Executive Committee**

Ben D. McCallister, MD, Chairman  
Tom E. Bowser, CEO  
David R. Bywaters  
Anita B. Gorman  
Karon Harris Hicks  
Janice C. Kreamer  
William C. Nelson  
Travis D. L. Newsome  
Danley K. Sheldon

**Audit Committee**

Danley K. Sheldon, Chairman  
David R. Bywaters  
Anita B. Gorman  
Garry K. Kemp  
William C. Nelson  
James R. Roath

**Personnel Committee**

Lyle K. Querry, Chairman  
David R. Bywaters  
Melvin L. Glazer, M.D.  
Karon Harris Hicks  
Garry K. Kemp  
Sam R. Reda  
James R. Roath  
Larry A. Rues, M.D.

**Governance Committee**

Anita B. Gorman  
Danley K. Sheldon  
William C. Nelson  
Janice C. Kreamer  
Karon Harris Hicks

**Health Policy and Quality Committee**

Larry A. Rues, M.D., Chairman  
Melvin L. Glazer, M.D.  
Janice C. Kreamer  
Travis D. L. Newsome  
Lyle K. Querry  
Sam R. Reda

## **Officers**

The Board of Directors annually elect various Company officers, as required by the Bylaws. The senior officers elected and serving as of December 31, 2004, were as follows:

Tom E. Bowser	President and Chief Executive Officer
John W. Kennedy*	Executive Vice President
Peter K. Yelorda	Executive Vice President and Chief Administrative Officer
Frank J. DiTirro, MD, PhD#	Senior Vice President and Chief Medical Officer
Roger L. Foreman**	Senior Vice President and Chief Marketing Officer
David R. Gentile***	Senior Vice President of Operations
Marilyn T. Tromans	Vice President, Chief Financial Officer and Treasurer
Sharon I. O'Connor	Secretary

\* Effective January 1, 2005, John W. Kennedy became the Executive Vice President and Chief Operating Officer.

# Effective January 12, 2006, Frank DiTirro MD, resigned as Senior Vice President and Chief Medical Officer. This officer position remained vacant as of the date of this report.

\*\* Effective January 1, 2005, Roger L. Foreman became Executive Vice President and Chief Marketing Officer.

\*\*\* Effective January 1, 2005, David R. Gentile became Executive Vice President and Chief Member Services and Subsidiaries Officer.

## **Conflict of Interest**

The Company has implemented a conflict of interest policy, which establishes procedures for the disclosure of any conflicts of interest that may exist. All officers and directors are required to complete a conflict of interest statement every year. Signed statements of officers and directors were reviewed for the examination period. No significant exceptions were noted.

### **Corporate Records**

The Company's Articles of Consolidation and Bylaws were reviewed for the period under examination. The Articles of Consolidation were not amended during the examination period. The Bylaws were amended on May 15, 2002, to empower the Executive Committee to exercise the authority of the full Board of Directors in the event of an emergency or disaster, to require all board members to be covered by a health plan issued or administered by the Company, to create the Immediate Past Chairman officer position, to require the Personnel Committee to review board members' compensation at least every three years and to reduce the membership of the Executive Committee from eight to six, with a quorum of three members. The Bylaws were amended on May 21, 2003, to change the name of the Board Charge to Board Charter and to add the position of Assistant Corporate Secretary as an officer of the Company. The Bylaws were also amended on May 12, 2004, to require that a majority of the members of the Board of Directors be independent, to change the name of the Board Development Committee to the Governance Committee, to require all members of the Audit Committee to be independent directors, to give authority to the Audit Committee to appoint the external audit firm and to require a majority of the Personnel Committee and the Governance Committee members to be independent directors. The Bylaws were again amended on June 30, 2004, to set a minimum of six and a maximum of nine members to serve on the Executive Committee, with the Chairman of the Board having the authority to appoint three members to serve one year terms.

The minutes of the Board of Directors meetings and the committee meetings were reviewed for proper approval of corporate transactions. In general, the minutes appear to properly reflect and approve the Company's major transactions and events for the period under examination.

### **Acquisitions, Mergers and Major Corporate Events**

Several changes to the subsidiaries of BCBS of Kansas City occurred during the examination period, as follows:

- November 22, 2002 – Dissolved and liquidated Healthy Deliveries, LLC.
- August 29, 2003 – Pursuant to the approval of the Board of Directors of August 18, 2003, BCBS of Kansas City purchased 2301 Main Street, Kansas City, Missouri, its current home office for \$22.5 million. BCBS of Kansas City formed and incorporated a subsidiary, Group Health Property Company of Kansas City, LLC to own the property and then to lease it to the Company. On September 22, 2005, Group Health Property Company of Kansas City, LLC, was liquidated and the lease terminated. The building is now directly owned by the Company.
- February 4, 2004 – Pursuant to the consent of its sole shareholder, TriLink HealthCare, Inc. (TriLink) was dissolved. At the time of the dissolution, TriLink owned 100% of Preferred Health Professionals (PHP), Premier WorkComp Management, LLC, (Premier WorkComp), Missouri Valley Life and Health Insurance Company (Missouri Valley) and Pharma-Link, Inc (Pharma-Link). At the date of dissolution, TriLink also owned

50% of The EPOCH Group, LLC (EPOCH) and New Directions Behavioral Health, LLC (New Directions). After the distribution of the liquidated assets on February 29, 2004, all the assets and liabilities of TriLink were transferred to the Company. Consequently, TriLinks wholly owned subsidiaries, including Missouri Valley, PHP, Premier WorkComp and Pharma-Link became wholly owned subsidiaries of the Company.

- September 19, 2004 - The Board of Directors approved the formation of PH Professionals, LLC. (Professionals) and on September 27, 2004, Professionals and PHP merged with Professionals being the surviving entity. The merger was effective as of September 30, 2004, and Professionals was renamed Preferred Health Professionals, LLC or PHP.
- On September 19, 2004, the Company acquired the remaining 50% interest of New Directions Behavior Health, LLC from Menninger Clinic. New Directions Behavior Health, LLC manages the mental health benefits for the Company's insureds.
- April 18, 2005 – Blue-Advantage Plus of Kansas City, Inc., (Blue Advantage), was incorporated as a wholly owned subsidiary to operate as an HMO, specializing in Title XIX Medicaid business of the Company as a separate legal entity.
- November 28, 2005 - BCBS of Kansas City acquired the remaining 50% ownership interest in EPOCH, a third party administrator licensed in the State of Missouri. After the acquisition of EPOCH, the Company contributed 1% of its ownership interest to Good Health HMO, Inc., a subsidiary.

### **Surplus Debentures**

No surplus debentures were issued or outstanding as of December 31, 2004.

## **AFFILIATED COMPANIES**

### **Holding Company, Subsidiaries and Affiliates**

The Company is a member of an Insurance Holding Company System as defined by Section 382.010, RSMo (Definitions). An Insurance Holding Company System Registration Statement was filed by BCBS of Kansas City on behalf of itself and its subsidiaries for each year of the examination period.

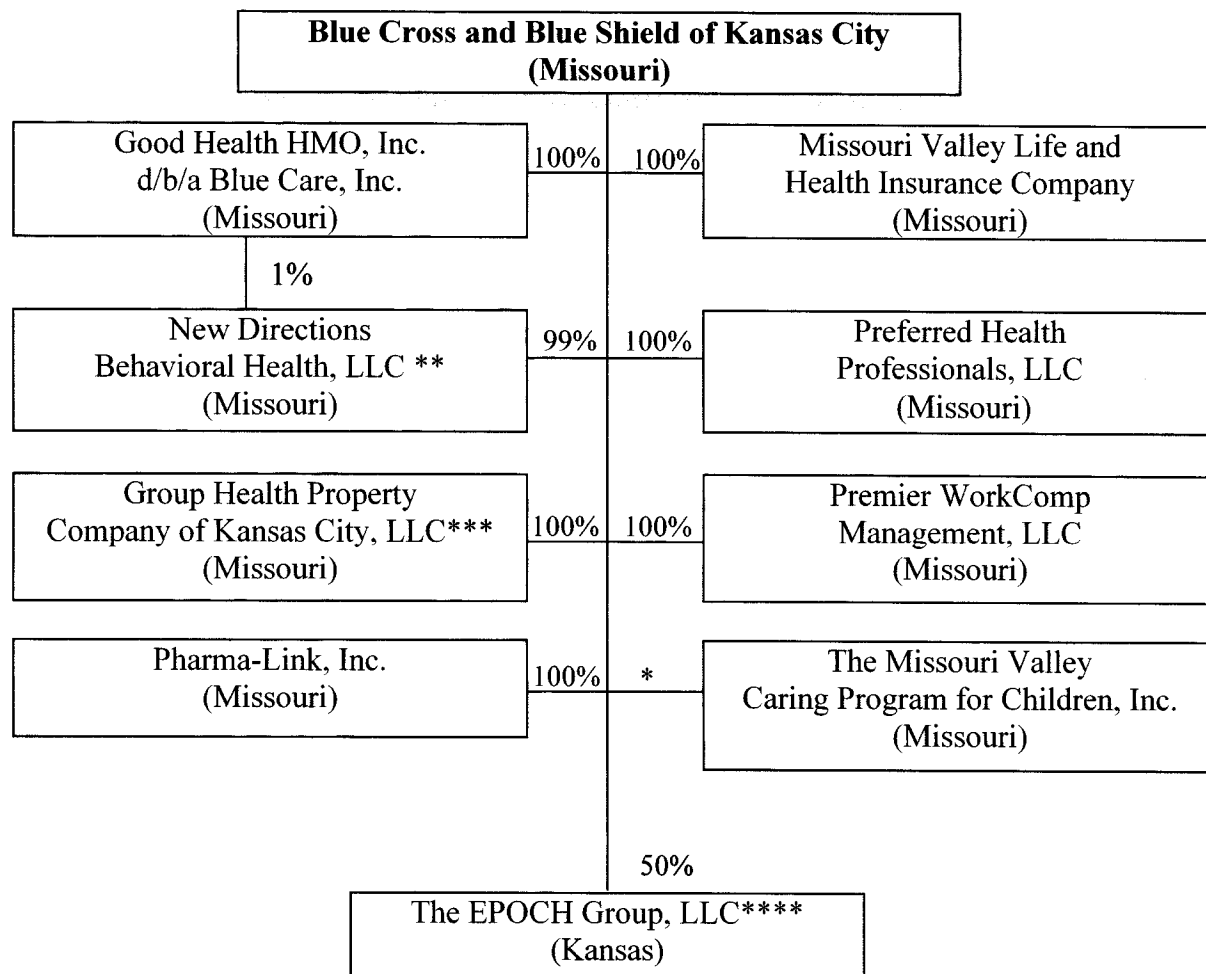
The Company is a not-for-profit organization and therefore, there are no stockholders or other ownership. BCBS of Kansas City is ultimately controlled by its Board of Directors.

BCBS of Kansas City has several subsidiaries that all have businesses involved in or related to the health care industry. These subsidiaries as of December 31, 2004, are as follows:

- Good Health HMO, Inc. d/b/a Blue Care, Inc. (Good Health) and Missouri Valley Life and Health Insurance Company (Missouri Valley) are Missouri domiciled insurers.
- The EPOCH Group, LLC (EPOCH) provides administrative services for third-party employers that have self-funded health insurance programs.
- Preferred Health Professionals, LLC (PHP) provides network rental and managed care services to groups, third-party claims administrators and insurance companies.
- Premier WorkComp Management, LLC (Premier WorkComp) provides clients with access to a provider network exclusively for the treatment of work-related injuries and illnesses.
- New Directions Behavioral Health, LLC (New Directions) manages behavioral health benefits and provides employees assistance programs for its customers.
- Pharma-Link, Inc. is a shell company with no operations.
- Group Health Property Company of Kansas City, LLC (Property Company) was created to hold BCBS of Kansas City's headquarters building, located at 2301 Main Street, Kansas City, Missouri.
- The Missouri Valley Caring Program for Children, Inc. is a nonprofit shell company with no operations.

**Organizational Chart**

The following organizational chart depicts BCBS of Kansas City's holding company system, as of December 31, 2004:



\*The Missouri Valley Caring Program, Inc. is a nonprofit corporation, with ownership belonging to its Board of Directors. However, The Missouri Valley Caring Program, Inc.'s Board of Directors is comprised entirely of BCBS of Kansas City officers. Thus BCBS of Kansas City has control over this entity.

\*\* Through BCBS of Kansas City's 100% ownership of Good Health HMO, Inc. d/b/a Blue Care, Inc., the Company has 100% ownership of New Directions Behavioral Health, LLC.

\*\*\* As of September 22, 2005, the Group Health Property Company of Kansas City, LLC was dissolved and all its operations were transferred to BCBS of Kansas City.

\*\*\*\* As of November 30, 2005, BCBS of Kansas City transferred ½% of its interest in EPOCH to Good Health. Subsequently on that same date, EPOCH redeemed a 50% interest of itself from a third party. As a result, BCBS of Kansas City owns 99% of EPOCH and Good Health owns the remaining 1%.

Note: As of April 18, 2005, BCBS of Kansas City organized and incorporated a wholly owned subsidiary, Blue Advantage Plus of Kansas City, Inc.

### **Intercompany Transactions**

The Company's intercompany agreements in effect, as of December 31, 2004, are outlined below.

- 1. Type:** Agreement for the Sharing of Federal Income Taxes and Filing of a Consolidated Tax Return  
**Affiliates:** TriLink HealthCare, Inc., Good Health, Missouri Valley, PHP, Pharma-Link, Inc.  
**Effective:** July 9, 2003  
**Terms:** BCBS of Kansas City will file a consolidated federal tax return for itself and its subsidiaries. The tax liability for each subsidiary shall be based upon each subsidiary's taxable income or loss as reflected in the consolidated financial statements. Each subsidiary will pay its federal income taxes to BCBS of Kansas City. BCBS of Kansas City will collect and remit any tax refunds to the subsidiaries.
- 2. Type:** Ancillary Provider Network Agreement  
**Affiliates:** New Directions, Good Health, TriLink HealthCare, Inc., TriSource HealthCare Inc., BMA Selectcare, Inc., EPOCH, Premier WorkComp, PHP, Healthy Deliveries, LLC, Missouri Valley  
**Effective:** March 1, 2000; amended January 1, 2002, March 1, 2003, January 1, 2004, and January 1, 2005. All amendments were to change capitation rates or extend expiration of capitation rates.  
**Terms:** New Directions agrees to manage and/or arrange for the provision of behavioral health and substance abuse services for BCBS of Kansas City's members and the members of BCBS of Kansas City's subsidiaries. New Directions will provide for the credentialing reviews of the providers. BCBS of Kansas City will pay New Directions a capitation payment each month that is determined by the per member per month rates specified in the agreement. The rates vary between products sold by BCBS of Kansas City and its subsidiaries.  
**Exception:** The Company has amended the Ancillary Provider Network Agreement three times during the examination period to change capitation rates or to extend expiration of capitation rates, without filing a Form D for approval from the

MDI as required by Section 382.195 RSMo (Prohibited Transactions, Exceptions). The Company is directed to submit a Form D filing for the amendments to the agreement. Also, the Company's listing of affiliates contains affiliates that were dissolved during the examination period. The Company is directed to restate this agreement to include all the amendments and an accurate listing of affiliated entities that are parties to the agreement in accordance with the applicable law.

**3. Type:** Administrative Services Agreement

**Affiliate:** Good Health

**Effective:** January 1, 2003

**Terms:** BCBS of Kansas City agrees to provide the following administrative services: accounting, budgeting, personnel, payroll, office space, utilities, maintenance, claims processing, purchasing, legal, actuarial, underwriting, cash management, investment, marketing, data processing, and other services. Good Health will pay BCBS of Kansas City the actual expenses incurred for the services provided.

**Exception:** BCBS of Kansas City was not collecting payment for Good Health's monthly expenditures as stipulated in the agreement. The Company is directed to ensure that its accounting procedures, including payment and receipt of payment, are in accordance with the intercompany agreements.

**4. Type:** Administrative Services Agreement

**Affiliate:** Missouri Valley

**Effective:** June 1, 1996

**Terms:** BCBS of Kansas City agrees to provide the following administrative services: accounting, budgeting, personnel, payroll, office space, utilities, maintenance, claims processing, purchasing, legal, actuarial, underwriting, cash management, investment, marketing, data processing, and other services. Missouri Valley will pay BCBS of Kansas City the actual expenses incurred for the services provided.

**Exception:** BCBS of Kansas City was not collecting payment for Missouri Valley's monthly expenditures as stipulated in the agreement. The Company is directed to ensure that its accounting procedures, including payment and receipt of payment, are in accordance with the terms of intercompany agreements.

**5. Type:** Lease Agreement

**Affiliate:** Group Health Property Company of Kansas City, LLC (Property Company)

**Effective:** August 29, 2003



**Terms:** BCBS of Kansas City agrees to pay as base rent \$138,020.50 each month; effective on the first day of the month for its headquarter offices. The lease was canceled on August 29, 2005 and Property Company was dissolved on September 22, 2005.

**Exception:** During the entirety of the lease period, BCBS of Kansas City did not pay rent to Property Company, contrary to the provisions of the lease agreement. The Company is directed to ensure its that its accounting procedures, including payment and receipt of payment, are in accordance with the terms of intercompany agreements.

**6. Type:** Agreement for the Management of Intercompany Payables and Receivables

**Affiliates:** TriLink HealthCare, Inc., Missouri Valley, Good Health, PHP, Preferred Prescriptions, Inc., Pharma-Link, Inc., BMA SelectCare, Inc., and TriSource Healthcare, Inc.

**Effective:** July 1, 2000; Amended November 1, 2005

**Terms:** BCBS of Kansas City shall pay the payables and collect the receivables for its subsidiaries. Separate accounting records will be maintained for the transactions for each subsidiary. Transfers of funds to or from the subsidiaries will be made to minimize uninvested cash balances and to minimize the receivable or payable balance with each subsidiary. BCBS of Kansas City shall pool and retain the consolidated funds resulting from the transactions. BCBS of Kansas City will invest the pooled funds. BCBS of Kansas City shall pay interest or receive interest each month from the subsidiaries based upon the intercompany balance of each subsidiary. The interest rate shall be the applicable federal rate determined by the most recently published Internal Revenue Service Revenue Ruling. It was noted that TriLink HealthCare, Inc., Preferred Prescriptions, Inc., BMA SelectCare, Inc., and TriSource Healthcare, Inc. were dissolved before or during the examination period. The Company has since amended the agreement to remove these dissolved subsidiaries and added Blue Advantage Plus of Kansas City, Inc.

**Exceptions:** BCBS of Kansas City's cash account was reduced by \$506,101 and the amount reported by the Company for Receivable from Parent, Subsidiaries and Affiliates was increased by the same amount. This reclassification was made to properly reflect the Company's transaction with Good Health with respect to paid Good Health claims. See notes 1 and 5 on the Notes to the Financial Statements section of this report for additional details.

Contrary to the Company's assertion that balances under this agreement are settled on a quarterly basis, we noted an inconsistent pattern of settlement during the examination. For example, the Company's December 31, 2004, Intercompany Receivable balances (comprised of Good Health and Pharma-Link, Inc. receivables) were not settled in full until September 2005. It does

not appear that the Company is settling intercompany balances under this agreement in a consistent manner.

The Company is also charging or crediting interest on its subsidiaries' intercompany balances as a whole. The intercompany balances are comprised of federal tax allocations, administrative expense allocations, and lease payments, which are covered under separate intercompany agreements. The Company is including balances related to these agreements in the calculation of interest receivable/payable under the Agreement for the Management of Intercompany Payables and Receivables. Due to the untimely settlement of intercompany balances, this accounting treatment results in the Company's subsidiaries paying interest to BCBS of Kansas City for payables not covered under the Agreement for the Management of Intercompany Payables and Receivables. If the subsidiaries have a receivable due from the Company, it results in the subsidiaries losing investment income opportunities because the interest rate applied to these funds is generally lower than effective market rates. The Company's subsidiaries can achieve better interest rates in the open market if these funds were available to the subsidiaries through timely settlements.

The Company is directed to amend the Agreement for the Management of Intercompany Payables and Receivables to include specific settlement terms. The Company must file a Form D for this agreement with the MDI in accordance with RSMo 395.182 (Prohibited Transactions, Exceptions). The Company is also directed to desist from including other intercompany balances not covered by the Agreement for the Management of Intercompany Payables and Receivables in the calculation of interest under this agreement. The settlement and reporting for those agreements should be handled separately in accordance with settlement terms.

**7. Type:** Management Services Agreement

**Affiliates:** Premier WorkComp

**Effective:** January 1, 2003

**Terms:** BCBS of Kansas City will provide the following support and management services to Premier WorkComp: office space; phone system; receptionist; office supplies; copying, printing, fax, and mail; office furniture and equipment; internet/intranet activity; accounting; personnel and personnel support; legal services; and information technology and services. Premier WorkComp will pay BCBS of Kansas City for the actual cost of providing the aforementioned expenses.

**8. Type:** Collaboration Agreement

**Affiliate:** PHP

**Effective:** January 1, 2003; Amended December 23, 2004

**Terms:** BCBS of Kansas City grants PHP the right to market and sell access to its networks. PHP will pay BCBS of Kansas City an access fee of \$7.50 per enrolled employee of each group per month of the Freedom Network and Freedom Network Select. BCBS of Kansas City agrees to make available certain managerial and administrative employees to PHP. PHP will reimburse BCBS of Kansas City for the expenses of the loaned employees.

**Exception:** On September 27, 2004, Preferred Health Professionals, Inc. was merged with and into P H Professionals, LLC. On September 30, 2004, P H Professionals, LLC was renamed Preferred Health Professionals, LLC. The Company has not amended its Collaboration Agreement to reflect the name change of Preferred Health Professionals, Inc. to Preferred Health Professionals, LLC. The Company is directed to draft an amendment reflecting the name change and submit a Form D filing for this amendment, as required by Section 382.195 RSMo (Prohibited Transactions, Exceptions).

**9. Type:** Guarantor Agreement

**Affiliate:** Missouri Valley

**Effective:** March 1, 1991

**Terms:** BCBS of Kansas City agrees to provide any contributions to the capital and surplus of Missouri Valley necessary to maintain capitalization of \$1,500,000. The purpose of this agreement was to enable Missouri Valley to obtain a Certificate of Authority to do business in the State of Kansas.

**10. Type:** Guarantor Agreement

**Affiliate:** Good Health

**Effective:** January 1, 1993

**Terms:** In the event of the insolvency of Good Health, BCBS of Kansas City agrees to provide Good Health whatever guarantee or coverage that is necessary to meet all applicable requirements of its business as a state-qualified HMO. This coverage will provide for the continuation of covered benefits to Good Health's members and pay provider expenses, as defined in the agreement.

**11. Type:** Sub-SubLease Agreement

**Affiliate:** New Directions

**Effective:** April 1, 2004

**Term:** BCBS of Kansas City subleased office space to New Directions from April 1, 2004 to September 30, 2005. According to the agreement, New Directions was to pay BCBS of Kansas City at least \$1,549.33 a month. After the expiration of the lease, New Directions moved to a different office space. BCBS of Kansas City was not involved in this new lease.

**12. Type:** Administration Agreement

**Affiliate:** EPOCH

**Effective:** January 1, 2005

**Terms:** EPOCH agrees to provide claim processing and payment and premium billing and collecting for Missouri Valley's health PPO product. Missouri Valley is not a party of this agreement. Prior to January 1, 2005, BCBS of Kansas City covered these services under the Administrative Services Agreement and the Agreement for the Management of Intercompany Payables and Receivables.

**Exception:** The Administration Agreement between BCBS of Kansas City and EPOCH on behalf of Missouri Valley overlaps in functionality with the Agreement for the Management of Intercompany Payables and Receivables between BCBS of Kansas City and Missouri Valley. Specific areas of overlap include claims payment and premium billings and collections. Under this arrangement it is reasonable to assume that Missouri Valley could be double-billed for these services covered by two different overlapping agreements. The Company is directed to amend the Agreement for the Management of Intercompany Payables and Receivables and the Administration Agreement to specifically state that EPOCH is collecting premiums and paying claims only for Missouri Valley's direct pay PPO product.

In addition to the above agreements, it was also noted that the Company provides administrative services to its wholly owned subsidiary, Pharma-Link, Inc. (PLI). These services are not covered under an intercompany agreement and are not being accounted for on the Company's and PLI's general ledgers. The Company also did not disclose its ownership of PLI on Schedule Y - Part 1 of the Annual Statement. The Company is directed to draft an agreement and submit a Form D to the MDI for services provided to PLI, in accordance with RSMo 382.195 (Prohibited transactions, exceptions). Services that qualify as management services should be reported on Schedule Y - Part 2 of the Annual Statement.

The Company also has the following other intercompany transactions:

BCBS of Kansas City has a group term life insurance policy issued by its subsidiary, Missouri Valley. This policy provides a \$5,000 death benefit for members enrolled in the Company's Preferred Care Blue and Blue Advantage individual health products. The life insurance premium is \$1.50 per month for each insured life. BCBS of Kansas City pays premiums to Missouri Valley for the Company's eligible members.

**Intercompany Payments**

The following table summarizes the net amounts earned and incurred during the examination period, between BCBS of Kansas City and its subsidiaries.

Agreement or Transaction	Earned (Incurred) By BCBS of Kansas City		
	2004	2003	2002
Sharing of Federal Income Taxes	\$6,736,500	\$3,898,900	\$4,780,000
Ancillary Provider Network – New Directions	(13,230,557)	(14,159,398)	(13,415,815)
Administrative Services – Missouri Valley	754,720	724,526	692,831
Administrative Services – Good Health	18,903,856	17,703,227	14,991,081
Management of Intercompany Payables and Receivables	(36,641)	(8,751)	(11,611)
Management Services – Premier WorkComp	886,103	882,368	981,449
Collaboration – Preferred Health Professionals, LLC	10,346,042	10,813,672	9,774,440
Lease Agreement – Group Health Property Company	(1,656,246)	(552,082)	N/A
SubLease Agreement – New Directions	13,944	N/A	N/A
Term Life Insurance Policy with Missouri Valley	(865,932)	(787,007)	(708,092)
Surplus Note Receipts	14,772,446	N/A	N/A
Capital Contributions	45,082,359	(22,500,000)	0
Dividends	1,000,000	1,500,000	1,500,000
<b>TOTAL</b>	<b><u>\$16,855,486</u></b>	<b><u>\$19,222,781</u></b>	<b><u>\$16,357,335</u></b>

**FIDELITY BOND AND OTHER INSURANCE**

The Company and its subsidiaries are named insureds on a financial institution bond. The bond provides fidelity coverage with a liability limit of \$7,500,000 and a \$75,000 deductible. This coverage complies with the suggested minimum amount of fidelity insurance, according to NAIC guidelines.

The Company is also a named insured on the following insurance policies: property, excess liability, commercial umbrella, commercial auto, workers compensation and employers' liability, directors and officers' liability, and computer crimes.

## PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

As of December 31, 2004, the Company had approximately 1,000 employees. The employees work on the operations of BCBS of Kansas City and several subsidiaries. Employee benefit costs are allocated to the subsidiaries, pursuant to agreements that are described in the Intercompany Transactions section of this report. A variety of standard benefits are provided to the employees. These benefits include, but are not limited to, health insurance, dental insurance, disability insurance, life insurance, tuition reimbursement, and a 401(k) savings plan with matching contributions.

All vested employees are covered by a qualified, defined benefit pension plan that is managed by the Blue Cross and Blue Shield Association National Retirement Program. There are executives whose pension benefits under the qualified plan are reduced due to statutory limitations on earnings and benefits. These executives are provided with a non-qualified, Supplemental Executive Retirement Plan (SERP). Pension benefits for SERP participants are intended to cover any benefit reductions that must be imposed for the qualified, defined benefit plan. Eligible retired employees are also provided with postretirement benefits that provide medical, dental, and life insurance. The Company makes periodic contributions to fund the qualified pension plan. The unqualified SERP pension plan and the postretirement benefits are both unfunded.

BCBS of Kansas City had unrecognized or “off balance sheet” liabilities for its pension plans and its post-retirement benefits. These unrecognized liabilities result from the difference between the actual funded status of the plans and the liabilities that were recorded in accordance with statutory accounting principles (SAP). The unrecognized liabilities are as follows:

<u>Plan</u>	<u>Unfunded Amount as of 12/31/2004</u>	<u>Liability Recorded as of 12/31/2004</u>	<u>Unrecognized Liability</u>
Supp. Executive Pension	9,896,258	6,348,327	\$3,547,931
Post-Retirement Benefits	45,087,000	27,196,000	17,891,000

Incentive compensation or bonus plans have been established for most employees. Key employees, as determined by the Personnel Committee of the Board of Directors, are eligible for the Executive Long-Term Incentive Plan. Employees that directly supervise at least two other employees or contribute significantly to the Company are eligible for the Executive/Management Incentive Compensation Plan (E/MICP). Other employees that are not eligible for the above plans are eligible for the Employee Bonus Program and the Marketing Incentive Bonus.

<u>Incentive Plan or Program</u>	<u>Plan Year(s)</u>	<u>Eligible Employees</u>	<u>Amount Paid</u>	<u>Average per Employee</u>
Executive Long-Term	2002-2004	33	\$2,286,838	\$69,298
Management Incentive	2004	152	4,899,090	32,231
Employee Bonus Program	2004	869	2,633,996	3,031
Marketing Incentive	2004	227	270,381	1,191

## STATUTORY DEPOSITS

### **Deposits with the State of Missouri**

The funds on deposit with the Missouri Department of Insurance as of December 31, 2004, as reflected below, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with Section 354.075 RSMo (Capital Requirements) and Section 354.410 RSMo (Trust Deposits and Capital Requirements). The funds on deposit, as of December 31, 2004, were as follows:

<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
U.S. Treasury Notes	\$3,602,000	\$3,592,774	\$3,539,325

### **Deposits with Other States**

The Company does not have funds on deposit with any other states.

## INSURANCE PRODUCTS AND RELATED PRACTICES

### **Territory and Plan of Operation**

BCBS of Kansas City is licensed as a Health Services Corporation and also as a Health Maintenance Organization (HMO) by the Missouri Department of Insurance under Chapter 354 RSMo (Health Service Corporations – Health Maintenance Organizations – Prepaid Dental Plans). The Company is also a licensed insurer in the State of Kansas. The Company's service territory is concentrated in the Kansas City, Missouri metropolitan area and Northwest Missouri, which includes 30 counties in Missouri and 2 counties in Kansas. As of December 31, 2004, total membership was approximately 387,000.

Most of the Company's business is derived from its Preferred Provider Organization (PPO) and HMO products. These products are marketed under various names, depending on the size of the group. The Company also has a significant amount of Administrative Services Only (ASO) and Administrative Services Contract (ASC) plan business; for some groups enrolled in ASC coverage, the Company provides stop-loss insurance coverage. The Company also provides health insurance through its participation in the Federal Employee Program that is managed by the Blue Cross and Blue Shield Association. The Company also provides a small amount of dental coverage. Effective July 1, 2005, the Company transferred its Medicaid block of business to Blue Advantage Plus of Kansas City, Inc., a newly formed, wholly owned subsidiary.

The Company has a non-insurance division that does business under the name "Heartland Card Services." This operation is a component of BCBS of Kansas City and is not a separate subsidiary. Heartland Card Services produces plastic identification cards for Blue Cross and

Blue Shield plans and other entities. Gross revenues for the Heartland Card Services operation were almost \$1 million in 2004.

Third-party agents and brokers are utilized to obtain group business. The Company also has a staff of sales employees that sell individual and group business. The Company has its own marketing employees to promote the various products. Marketing methods include the use of television, radio, newspaper, and magazine advertisements, billboards, direct mail, and telemarketing.

**Policy Forms & Underwriting**

**Advertising & Sales Materials**

**Treatment of Policyholders**

The Missouri Department of Insurance has a market conduct staff that performs a review of the issues listed above, as well as reviews of providers/qualifications, contracts, and marketing initiatives which are documented in a separate market conduct report. The MDI conducted a market conduct exam for the period April 1, 2002 through September 30, 2002 with a report issued January 8, 2004. The report resulting from this examination was reviewed and no problems were found that would have a material impact on the Company's financial statements.



**REINSURANCE****General**

The Company's premium activity on a direct written, assumed and ceded basis, for the period under examination, is detailed below:

	<b><u>2004</u></b>	<b><u>2003</u></b>	<b><u>2002</u></b>
Direct Business	\$800,997,412	\$718,661,601	\$619,076,382
Reinsurance Assumed:			
Affiliates	0	0	0
Non-affiliates	11,637,240	12,801,660	14,622,589
Reinsurance Ceded:			
Affiliates	0	0	0
Non-affiliates	(1,491,241)	(1,422,444)	(1,343,487)
<b>Net Premiums Written</b>	<b><u>\$811,143,411</u></b>	<b><u>\$730,040,817</u></b>	<b><u>\$632,355,484</u></b>

**Assumed**

BCBS of Kansas City had two reinsurance agreements effective March 1, 1996, with Healthy Alliance Life Insurance (HALIC) whereby the Company assumed 100% of HALIC's individual and group contracts (excluding small groups) and 50% of HALIC's small group contracts, both on quota share basis.

These agreements were terminated by the parties on January 1, 2004, and are currently on run-off. Per the termination agreement, during the run-off period, the parties to the agreement shall continue to collect premiums and adjudicate claims per the terms of the reinsurance agreements.

The Company and HALIC entered into a new reinsurance agreement effective June 1, 2003. Under the terms of the agreement, BCBS of Kansas City assumes a variable percentage of HALIC's group contracts issued to the Missouri State Teachers Association (MSTA). The Company's assumed percentage of the MSTTA group business is determined by the percentage of MSTTA members located in BCBS of Kansas City's service territory.

**Ceded**

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under the reinsurance agreement.

The majority of the Company's business is reinsured on an excess of loss basis with high retentions. All reinsurers are authorized carriers in the State of Missouri.

The Company has an excess of loss reinsurance agreement, effective January 1, 1992, with BCS Insurance Company. This agreement covers the Company's Preferred Provider Organizations (PPO), major medical, and stop loss products. The retentions, coverage, limits, and premiums are renegotiated each year and formalized into a schedule signed by both parties. For 2004, the Company's retention was \$500,000 per member per year with a separate aggregate retention of \$800,000 in addition to the per member retention. The reinsurer's specific stop loss maximum liability is \$1,500,000 per covered individual per reinsurance period. The scheduled terms for the 2005 agreement are the same as 2004 agreement.

The Company has an excess of loss agreement, effective January 1, 2004 and terminating on December 31, 2004, with BCS Insurance Company for its Medicare Supplement product. The Company's retention is \$150,000 per member. The reinsurance coverage is 90% of the expenses in excess of the retention for transplant providers, 80% for fixed fee providers and 50% for non-fixed fee providers. Per diem limits of \$666 apply to inpatient hospital stays at certain providers and \$2,000 for acute care. The Company also executed a renewal agreement, effective January 1, 2005 and terminating on December 31, 2005, with BCS Insurance Company. The 2005 agreement has generally the same terms, retentions, coverages, limits, and premiums as specified in the 2004 Medicare Supplement agreement.

The Company is reinsured by an excess of loss agreement, effective January 1, 2004 and terminating on December 31, 2004, with BCS Insurance Company. This agreement provides reinsurance coverage for BCBS of Kansas City's commercial HMO and commercial point of service (POS) products, in and out of network. The Company's retention is \$500,000 per member per year. The reinsurance coverage is 90% of the expenses in excess of the retention for LifeTrac or Blue Quality Centers for Transplants providers, 80% for fixed fee providers and 50% for non-fixed fee providers. Per diem limits of \$2,000 apply for acute care. The maximum reinsurance liability is \$2,000,000 per member per lifetime.

This agreement was renewed effective January 1, 2005, to terminate on December 31, 2005. The agreement terms with respect to retentions, coverage, limits and premiums are identical to the 2004 terms described above. It should be noted, however, that the Company failed to file this new agreement with the MDI within 10 days of execution pursuant to Missouri Regulation, 20 CSR 400-7.140 (2), Health Maintenance Organizations - Reinsurance Agreements. The Company is directed to comply with this regulation.

The Company has a coinsurance agreement, effective December 15, 1998, with General Electric Capital Assurance Company (GECAC) for a long-term care product. BCBS of Kansas City cedes 100% of the risks for the long-term care policies to GECAC.

## ACCOUNTS AND RECORDS

### General

The CPA firm, Deloitte & Touche, LLP, of Kansas City, Missouri, issued audited statutory financial statements of the Company for all years in the examination period.

Policy and claim reserves were reviewed and certified by David O. Thoen, FSA, MAAA, with Deloitte & Touche Consulting LLP, of Minneapolis, Minnesota.

## FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of BCBS of Kansas City for the period ending December 31, 2004. Any examination adjustments to the amounts reported in the financial statements and/or comments regarding such are made in the “Notes to the Financial Statements.” The failure of any column of numbers to add to its respective total is due to rounding or truncation.

There may have been additional differences found in the course of this examination, which are not shown in the “Notes to the Financial Statements.” These differences were determined to be immaterial concerning their effect on the financial statements, and therefore were only communicated to the Company and noted in the workpapers for each individual Annual Statement item.

## Assets

	<u>Assets</u>	Nonadmitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$202,278,125	0	\$202,278,125
Common Stocks	192,220,264	\$13,549,909	178,670,355
Real Estate	4,506,746	0	4,506,746
Cash and Short-term Investments <b>Note #1</b>	33,843,043	506,101	33,336,942
Other Long-Term Invested Assets	40,482,807	14,843,943	25,638,864
Receivable for Securities	117,572		117,572
Investment Income Due and Accrued	1,978,493		1,978,493
Uncollected Premiums and Agents' Balances	19,600,636	12,500	19,588,136
Amounts Receivable on Uninsured Plans	23,859,163	149,000	23,710,163
Net Deferred Tax Asset	23,921,000	13,011,000	10,910,000
Electronic Data Processing Equipment	19,968,046	14,274,195	5,693,851
Furniture and Equipment	4,454,474	4,454,474	0
Receivable from Subs. & Affiliates <b>Note #2</b>	4,506,535	(506,101)	5,012,636
Health Care Receivable	38,629,244	1,939,201	36,690,043
Other Assets Non-Admitted	15,445	15,445	0
Aggregate Write-Ins for Other Assets:			0
Accounts Receivable – Embossed Cards	190,142	190,142	0
Prepaid Pension Benefit Cost	24,799,617	24,799,617	0
Prepaid Expenses	5,054,778	5,054,778	0
Other	1,289,103	1,289,103	0
Intangible Supp. Retirement Plan Asset	<u>796,848</u>	<u>0</u>	<u>796,848</u>
<b>TOTAL ASSETS</b>	<b><u>\$642,512,081</u></b>	<b><u>\$93,583,307</u></b>	<b><u>\$548,928,774</u></b>

## Liabilities, Surplus and Other Funds

Claims Unpaid	\$98,839,566
Accrued Medical Incentive Pool and Bonus Payments	608,851
Unpaid Claims Adjustment Expenses	5,102,760
Aggregate Health Policy Reserves	9,518,659
Aggregate Health Claim Reserves	1,877,159
Premiums Received in Advance	32,673,063
General Expenses Due or Accrued	26,942,034
Federal Income Taxes Payable	18,231,851
Ceded Reinsurance Premiums Payable	577
Amounts Withheld or Retained for the Account of Others	3,290,762
Remittances and Items not Allocated	998,919
Amounts Due to Parent, Subsidiaries and Affiliates	2,315,405
Payable for Securities	272,672
Liability for Amounts Held Uninsured A&H Plans	11,792,630
Aggregate Write-Ins for Liabilities:	
Unfunded Post-Retirement Benefit Obligation	27,196,000
Deferred Loss on Operating Lease	1,674,782
Accrued Supplemental Retirement Plan Liability	6,348,327
Other	<u>2,054,913</u>
<b>TOTAL LIABILITIES</b>	<b>\$249,738,930</b>
Aggregate Write-Ins for Other Surplus Funds	1,000,000
Unassigned Funds (Surplus)	<u>298,189,844</u>
Capital and Surplus	<u><b>\$299,189,844</b></u>
<b>TOTAL LIABILITIES AND SURPLUS</b>	<u><b>\$548,928,774</b></u>

## Statement of Revenue and Expenses

Net Premium Income	\$811,143,411
Change in Unearned Premium Reserves	<u>(1,645,624)</u>
<b>TOTAL REVENUES</b>	<b>\$809,497,787</b>
Hospital/Medical Benefits	\$549,866,440
Emergency Room and Out-of-Area	12,341,454
Prescription Drugs	80,131,643
Net Reinsurance Recoveries	(10,096,759)
Incentive Pool, Withhold Adjustments and Bonus Amounts	885,116
Claims Adjustment Expenses	33,743,641
Increase in Reserves for Accident and Health Contracts	1,157,766
General Administrative Expenses	<u>80,323,325</u>
<b>TOTAL UNDERWRITING DEDUCTIONS</b>	<b><u>\$768,546,144</u></b>
<b>NET UNDERWRITING GAIN</b>	<b>\$40,951,643</b>
Net Investment Income Earned	21,598,498
Net Realized Capital Gains or (Losses)	(8,447,475)
Aggregate Write-ins for Other Income or Expenses:	
Embossed Card Revenue	393,473
Federal Income Taxes Incurred	<u>12,850,768</u>
<b>NET INCOME (LOSS)</b>	<b><u>\$41,645,371</u></b>

## Capital and Surplus Account

Capital and Surplus, December 31, 2003	\$237,823,914
Net Income	41,645,371
Net Unrealized Capital Gains and Losses	39,110,412
Change in Net Deferred Income Tax	(835,000)
Change in Nonadmitted Assets	(27,126,781)
Aggregate Write-ins for Gains or (Losses) in Surplus:	
Change in Additional Minimum Pension Liability	<u>8,882,419</u>
Change in Additional Minimum Supplemental Retirement Liability	<u>(310,491)</u>
<b>Net Change in Capital and Surplus</b>	<b><u>\$61,365,930</u></b>
 <b>CAPITAL AND SURPLUS, DECEMBER 31, 2004</b>	 <b><u>\$299,189,844</u></b>

## Notes to the Financial Statements

<b>Note 1 – Cash and Short-term Investments</b>	<b>\$33,336,942</b>
<b>Notes 2 Receivable from Parent, Subsidiaries and Affiliates</b>	<b>\$5,012,636</b>

The amount reported by BCBS of Kansas City for Cash and Short-term Investments was reduced by \$506,101 and the amount reported by the Company for Receivable from Parent, Subsidiaries and Affiliates was increased by \$506,101. This reclassification was made to properly reflect the Company's transaction with Good Health with respect to payment of Good Health's claims. At December 31, 2004, BCBS of Kansas City reported paid, but uncleared claim checks in the amount of \$506,101 on behalf of Good Health, which should have been reported as a receivable from Good Health and a reduction of the Company's cash account. BCBS of Kansas City has an account with First National Bank for payment of Good Health claims. Good Health is then required to reimburse BCBS of Kansas City. As of December 31, 2004, BCBS of Kansas City did not record the \$506,101 of outstanding claim checks for the First National Bank account, which overstated the Company's cash position. The Company is directed to report as cash only those amounts that actually reside with the bank, net of any outstanding checks written or other funds transferred by BCBS of Kansas City on behalf of itself or any of its subsidiaries.

## Examination Changes

None.

## General Comments and/or Recommendations

### **Ancillary Provider Network Agreement (page 12)**

The Company has amended the Ancillary Provider Network Agreement many times and changed the list of the parties to the agreement without filing a Form D for prior approval from the MDI as required by Section 382.195 RSMo (Prohibited Transactions, Exceptions). The Company is directed to submit a Form D filing for these changes.



**Administrative Services Agreements and Lease Agreement (pages 13 and 14)**

The Company is not in compliance with the payment and settlement procedures outlined in each of the Administrative Services Agreement with Good Health and Missouri Valley (Agreements). The Agreements specify that payment for the previous month's services should be received by the 15th of the subsequent month. Instead of billing for the services under these agreements as stipulated, BCBS of Kansas City is combining the settlement with that of the Agreement for the Management of Intercompany Payables and Receivables (Management Agreement), which are generally settled quarterly with an imputed interest. The Company can amend the Agreements to change the payment and settlement periods by filing a Form D with the MDI as required by RSMo 395.182 (Prohibited Transactions, Exceptions). In the meantime, the Company should abide by the settlement periods in the Agreements.

In addition, BCBS of Kansas City entered into a lease agreement with the Property Company, a subsidiary, for its home office. For the entirety of the lease term, BCBS of Kansas City did not pay the agreed upon rent, contrary to the lease terms. Again, the Company is directed to follow payment and settlement terms in all agreements entered into with subsidiaries and affiliates. If a different course of action is desired, the Company must amend the agreement terms and file the applicable Form D with the MDI as required by RSMo 395.182 (Prohibited Transactions, Exceptions).

**Agreement for Intercompany Payables and Receivables (pages 14 and 15)**

BCBS of Kansas City is not settling balances under this agreement on a consistent manner. The Company is also combining balances from unrelated agreements with subsidiaries to the settlement terms under this agreement. The Company is directed to amend the Agreement for the Management of Intercompany Payables and Receivables to include specific settlement terms by filing a Form D with the MDI in accordance with RSMo 395.182 (Prohibited Transactions, Exceptions). The Company is also directed to desist from including other intercompany balances not covered by the Agreement for the Management of Intercompany Payables and Receivables in the calculation of interest under this agreement.

**Collaboration Agreement (page 16)**

The predecessor name of Preferred Health Professionals, LLC is still listed on this agreement, although the name change occurred on September 27, 2004. The Company is directed to draft an amendment reflecting the name change and submit a Form D filing for this amendment, as required by Section 382.195 RSMo (Prohibited Transactions, Exceptions).

**Administration Agreement (page 17)**

The Administration Agreement between BCBS of Kansas City and EPOCH on behalf of Missouri Valley overlaps in functionality with the Agreement for the Management of Intercompany Payables and Receivables between BCBS of Kansas City and Missouri Valley. The Company is directed to amend the Agreement for the Management of Intercompany

Payables and Receivables and the Administration Agreement to specifically state that EPOCH is collecting premiums and paying claims only for Missouri Valley's direct pay PPO product.

**Transaction with Pharma-Link, Inc. (page 17)**

It was also noted that the Company provides administrative services to its wholly owned subsidiary, Pharma-Link, Inc. (PLI). These services are not covered under an intercompany agreement and are not being accounted for on the Company's and PLI's general ledgers. The Company also did not disclose its ownership of PLI on Schedule Y - Part 1 of the Annual Statement. The Company is directed to draft an agreement and submit a Form D to the MDI for services provided to PLI, in accordance with RSMo 382.195 (Prohibited transactions, exceptions). Services that qualify as management services should be reported on Schedule Y - Part 2 of the Annual Statement.

**Ceded Reinsurance Agreement (page 23)**

The Company has a ceded reinsurance agreement with BCS Insurance Company. The agreement was renewed effective January 1, 2005. However, the Company failed to file this new agreement with the MDI within 10 days of execution pursuant to Missouri Regulation, 20 CSR 400-7.140 (2), Health Maintenance Organizations - Reinsurance Agreements. The Company is directed to comply with this regulation.

**Cash and Short-term Investment (page 29)**

**Receivable from Parent, Subsidiaries and Affiliates (page 29)**

The account balance reported by the Company for the above Annual Statement line items was adjusted to correct improper reporting and classification arising from related party transactions. BCBS of Kansas City is directed to report the effects of intercompany transactions in a manner that is consistent with the terms of the agreement and related Annual Statement instructions.

## SUBSEQUENT EVENTS

On April 18, 2005, the Company incorporated Blue-Advantage Plus of Kansas City, Inc., (Blue-Advantage Plus) as a wholly owned subsidiary. The Company transferred \$8,000,000 of assets to Blue-Advantage Plus in exchange for 100% of its outstanding commons stock (10,000 shares of \$1.00 par value shares). Blue-Advantage Plus was issued a certificate of authority on June 20, 2005, by the Missouri Department of Insurance to operate as Health Maintenance Organization (HMO) under Missouri law at Chapter 354 as it pertains to HMOs. Blue-Advantage Plus was organized and incorporated to take over and manage BCBS of Kansas City's Title XIX Medicaid business. BCBS of Kansas City and Blue-Advantage Plus have entered into related party agreements through which the Company will provide various management and administrative services to Blue-Advantage Plus. Blue-Advantage Plus began actual operations on July 1, 2005.

On September 22, 2005, the Company dissolved Group Health Property Company of Kansas City, LLC (Property Company). Property Company was incorporated for the sole purpose of holding the Company's main office building to ensure eligibility of tax abatements. After the expiration of the tax abatements, the building was transferred from Property Company to the Company.

On November 30, 2005, the Company transferred one half of one percent of its ownership of EPOCH Group, LLC (EPOCH) to Good Health. Subsequent to the transfer, EPOCH redeemed a fifty percent ownership in itself from an unrelated third party. After this redemption, the Company held ninety-nine percent of EPOCH and Good Health held the remaining 1%.


**ACKNOWLEDGMENT**

The assistance and cooperation extended by the officers and the employees of Blue Cross and Blue Shield of Kansas City during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Bernie Troop, CFE, Alvin Garon, CFE, Leslie Nehring, CFE, and Andy Balas, CFE, AES, examiners for the Missouri Department of Insurance, participated in this examination. In addition, Bertram Oparaji, CFE, representing the Kansas Department of Insurance also participated in the examination. The firm of Milliman, Inc., of St. Louis, Missouri also participated as a consulting actuary.


**VERIFICATION**

State of Missouri                    )  
  )  
County of                            )

I, Levi N. Nwasoria, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of Blue Cross and Blue Shield of Kansas City, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

  
Levi N. Nwasoria, CPA, CFE  
Examiner-In-Charge  
Missouri Department of Insurance

Sworn to and subscribed before me this 7<sup>th</sup> day of April, 2006.

My commission expires: 03/17/2008        
Notary Public

BEVERLY M. WEBB  
Notary Public - Notary Seal  
STATE OF MISSOURI  
County of Jackson  
My Commission Expires: March 17, 2008

**SUPERVISION**

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

A handwritten signature in cursive script, appearing to read 'Frederick G. Heese', written over a horizontal line.

Frederick G. Heese, CFE, CPA  
Audit Manager  
Missouri Department of Insurance

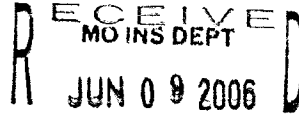


# BlueCross BlueShield of Kansas City

An Independent Licensee of the  
Blue Cross and Blue Shield Association

One Pershing Square  
2501 Main  
P.O. Box 419169  
Kansas City, MO 64141-6169  
Telephone: 816-395-2222  
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June 9, 2006



Mr. Kirk Schmidt  
Missouri Department of Insurance  
PO Box 690  
Jefferson City, MO 65102-0690

RE: Response to Exam: Blue Cross Blue Shield of Kansas City, Missouri Valley Life  
and Health Insurance Company and Good Health HMO, Inc. d/b/a Blue-Care

Dear Mr. Schmidt:

This letter is in response to your letter of May, 11, 2006 requesting written verification of compliance with the comments and recommendations from the financial examination for the above companies as of December 31, 2004. We request that our responses be included in the report as a public document.

Attached are responses to issues raised for each company separately. If after reading these responses you have additional questions, you can reach me at 816-395-2750, or by e-mail at [marilyn.tromans@bcbskc.com](mailto:marilyn.tromans@bcbskc.com).

Sincerely,

Marilyn Tromans  
Vice President, CFO

MT:lp

Attachments

**RESPONSES TO GENERAL COMMENTS AND/OR RECOMMENDATIONS –  
FINANCIAL EXAMINATIONS OF BLUE CROSS BLUE SHIELD OF KANSAS  
CITY**

1. Ancillary Provider Network Agreement (p 12) – The Company is currently revising this Agreement to incorporate all previous amendments and other desired revisions and will submit a Form D filing with the Department for prior approval of the revised Agreement.

2. Administrative Services Agreement and Lease Agreement (pages 13 and 14) – The Company will amend the Administrative Services Agreements between the Company and MVLH, and the Company and Good Health, to provide for settlements to occur quarterly and has submitted a Form D filing with the Department. The Company will also amend the Agreement for Intercompany Payables and Receivables to provide for settlements to occur quarterly and has submitted a Form D filing with the Department.

The Lease Agreement between the Company and Group Health Property Company was terminated effective September 15, 2005. If the Company enters into such leases in the future, it will comply with the payment terms of such leases.

3. Agreement for Intercompany Payables and Receivables (pages 14 and 15) – The Company will amend the Agreement for Intercompany Payables and Receivables to provide for settlements to occur quarterly and has submitted a Form D filing with the Department. The Amendment of the Agreement for Intercompany Payables and Receivables will also provide for interest calculations on balances arising from the agreement itself, as well as balances arising from other intercompany agreements specifically identified.

4. Collaboration Agreement (page 16) – Preferred Health Professionals LLC is the successor organization of the corporation Preferred Health Professionals. By operation of law, the merger of the predecessor corporation Preferred Health Professionals into the limited liability company Preferred Health Professionals LLC made the new LLC entity a party to the contract its predecessor had signed, without the need to change the name of the contracting party on the Agreement. Nevertheless, the Company will draft an amendment to the Agreement to reflect the current name of the contracting entity Preferred Health Professionals LLC and has submitted a Form D filing with the Department.

5. Administration Agreement (page 17) – The Company will amend the Agreement for Intercompany Payables and Receivables to explicitly state that the services provided by the Company to MVLH do not include the receipt of premiums and payment of claims for the MVLH direct pay PPO product.

**RESPONSES TO GENERAL COMMENTS AND/OR RECOMMENDATIONS –**  
**FINANCIAL EXAMINATIONS OF BLUE CROSS BLUE SHIELD OF KANSAS**  
**CITY – PAGE 2**

6. Transaction with Pharma-Link, Inc. (page 17) – PharmaLink was dissolved in 2006. In the future the Company will ensure that administrative services agreements are in place with all subsidiaries for which the Company provides services. In the future the Company will ensure services that qualify as management services are reported on Schedule Y – Part 2 of the annual statement.

7. Ceded Reinsurance Agreement (page 23) - The PPO stop-loss agreement was filed with the Department on March 13, 2006. The Medicare Supplement and HMO agreements were filed with the Department on April 21, 2006. When agreement is reached with the reinsurer on these agreements, the Company executes the documents first and then forwards them to the reinsurer to sign, per the reinsurer's instruction. In each case, the Company sent copies of the fully-executed agreements to the Department the day after they were received from the reinsurer.

8. Cash and Short-Term Investments (page 29); Receivable from Parent, Subsidiaries and Affiliates (page 29) – In the future the Company will properly report cash balances for all bank accounts as Cash and not report these amounts as Receivable from Parent, Subsidiaries and Affiliates.